From: Louis R. Hyman
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To: Comments
Subject: RIN 3064-ZA04

Robert E. Feldman, Executive Secretary

Federal Deposit Insurance Corporation

550 17th Street, NW, Washington, DC 20429

RIN 3064-ZA04

Dear Chairman McWilliams:

Thank you for the opportunity to provide comments to the FDIC as you consider how to encourage small-dollar lending from banks. I wanted to offer my perspective as a historian of consumer credit. My books *Debtor Nation: The History of America in Red Ink* and *Borrow: The American Way of Debt* have both explored how consumer credit has evolved in America. One of the themes that comes up repeatedly is that individuals frequently see themselves using credit responsibly, while viewing others' use of credit as problematic. At the same time, as we saw during the financial crisis, markets often require some guardrails to function well. Regulations are most successful when they align the interests of capital with those of society.

In recent decades, banks have largely been prevented by prudential regulators from making small installment loans to consumers. Requiring extensive documentation, for even small loans, is expensive to conduct and it has stopped banks from lending small amounts to their checking account customers at reasonable prices. As a result, consumers are left with payday loans from nonbanks at APRs in the range of 400 percent or absurdly expensive penalty overdraft fees.

Earlier in our history, we confronted a similar situation. In the Great Depression, nonbank lenders charged high fees to a hard-pressed public. In response, the federal government encouraged banks, through a system of loan guarantees in 1934, to make small personal loans based on little more than proof of a job and an address. These loans programs not only brought down borrowing costs, they also helped banks survive the Great Depression. Americans who had a job rarely defaulted when given a way to systematically, and affordably, pay back their debts.

Today, we can follow this example and once again make it easier for banks to lend to the working poor, though without loan guarantees or subsidies. Banks could easily offer a new small installment loan to their existing customers without increasing their overhead — and maybe even draw in new customers from a rival bank or those who are unbanked. In turn, small loans could become much cheaper. The APR for these bank small loans would probably be higher than the 36 percent the FDIC has recommended in the past, but it would represent enormous savings for payday loan borrowers, most of whom do not qualify for other bank credit products and instead pay overdraft penalty fees.

It may be tempting for regulators to dictate whether borrowing a small amount of money is someone's best option or not. But that approach has left us in the bind we are in today. Banks saying "no" to consumers seeking credit has meant that consumers seek out a "yes" from high-cost payday lenders. The FDIC, instead, can provide banks with clear and easy-to-implement guidelines around safe products that borrowers can successfully qualify for and repay with simple underwriting standards like affordable payments capped at a small share of a consumer's income. This will make it easier to offer and qualify for safe installment loans at low costs and allow the lowest-cost lenders to compete. That recipe has worked in the past and it represents enormous savings for payday loan borrowers today.

The fact that every payday loan customer has an income and a checking account is striking. The role that regulatory barriers have played in preventing banks from offering small loans to their customers makes one wonder whether a large fraction of the alternative financial services landscape would disappear if banks gained the needed regulatory clarity to simply offer small installment loans directly at prices many times lower than payday lenders.

With smart rules, and some historical perspective, the FDIC can promote lower-cost competition, consumer protection, and financial inclusion by enabling banks to directly make loans with affordable payments. American consumers can – and should – be much better served.

Louis Hyman

Associate Professor, Cornell University

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Appendix

http://www.huffingtonpost.com/louis-hyman/paying-off-payday-loans_b_8230382.html

How to Protect the Working Poor From 300 Percent Interest Rates

10/02/2015

The payday loan is not, as Republican presidential candidate Ben Carson recently wrote, a "short-term loan secured by their next paycheck with an interest rate around 15 percent." Rather than 15%, payday loans, which few borrowers pay off the following week, end up with effective interest rates actually above 300%.

Imagine borrowing $350 on your credit card and not paying it back for six months (just like the average payday borrower). If it were a high-interest card, your interest rate would be around 29%. If you paid the debt off in about six months (like typical payday borrowers do) you would have forked over $51 in interest. For payday borrowers that number would be nine times higher—$458. For the 12 million Americans who borrow from payday lenders each year, collectively paying about $8 billion in fees, these high fees appear to be the only option. While wrong on his numbers, Carson is correct that payday loans are an "essential necessity to get by" for the working poor. The question, however, is not whether to have payday loans, but how to make them more affordable.

The common explanation for these high fees is simple: the borrowers are risky. Higher rates compensate lenders for their higher losses. Yet, as lenders' own public filings have shown, this explanation is wrong.

The main driver of payday lenders' costs are not loan defaults, but old-fashioned overhead. As storefronts with few customers—lenders average just 500 unique borrowers a year—about two-thirds of their costs are in overhead. Only one-sixth of payday lenders' costs come from loan defaults.

One obvious option would be taking payday loans online — cutting out the rent and increasing the volume — but the internet savings, it turns out, are offset by the internet fraud.

Carson fears that a “nanny state” will step in to regulate these lenders out of existence, further denying the poor access to financial services. Luckily for policymakers, there exists a far easier option: allow banks to make payday loans repaid in affordable installments.

Instead of pretending that payday loans can be paid off the following week, it would be far better to accept that these loans require a few months to payoff and create an installment plan to match borrower’s realities. The Pew Charitable Trusts estimates that a viable $500, 4-month loan from a bank would cost somewhere around $80, compared with $400-$600 from a payday lender. The APR for the bank small loan is higher than a typical credit card APR, but it would represent enormous savings for payday loan borrowers, most of whom do not qualify for other bank credit products and instead pay overdraft penalty fees. To issue these loans, banks would need to be allowed to use simple underwriting standards of the sort outlined by the Consumer Financial Protection Bureau, where monthly installment payments are limited to an affordable five percent of monthly income.

Bank regulators, like the Office of the Comptroller of the Currency, do not currently allow payday loans. These regulators require high standards of underwriting, for even small loans, which is expensive to conduct, preventing banks from lending to their checking account customers at reasonable prices.

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without increasing their overhead — and maybe even draw in those 500 customers from a rival bank. In turn, payday loans could become much cheaper.

Banks, in this way, could compete payday lenders out of business. Regulation is not only about saying no, but helping institutions say yes to innovation. The choice is not either regulation or deregulation, as Carson implies, but smart regulation. If today's federal regulators get the small-dollar loan rules right, payday loan customers could get access to safer loans, save hundreds of dollars annually, and find something better to spend their money on—or even save.

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